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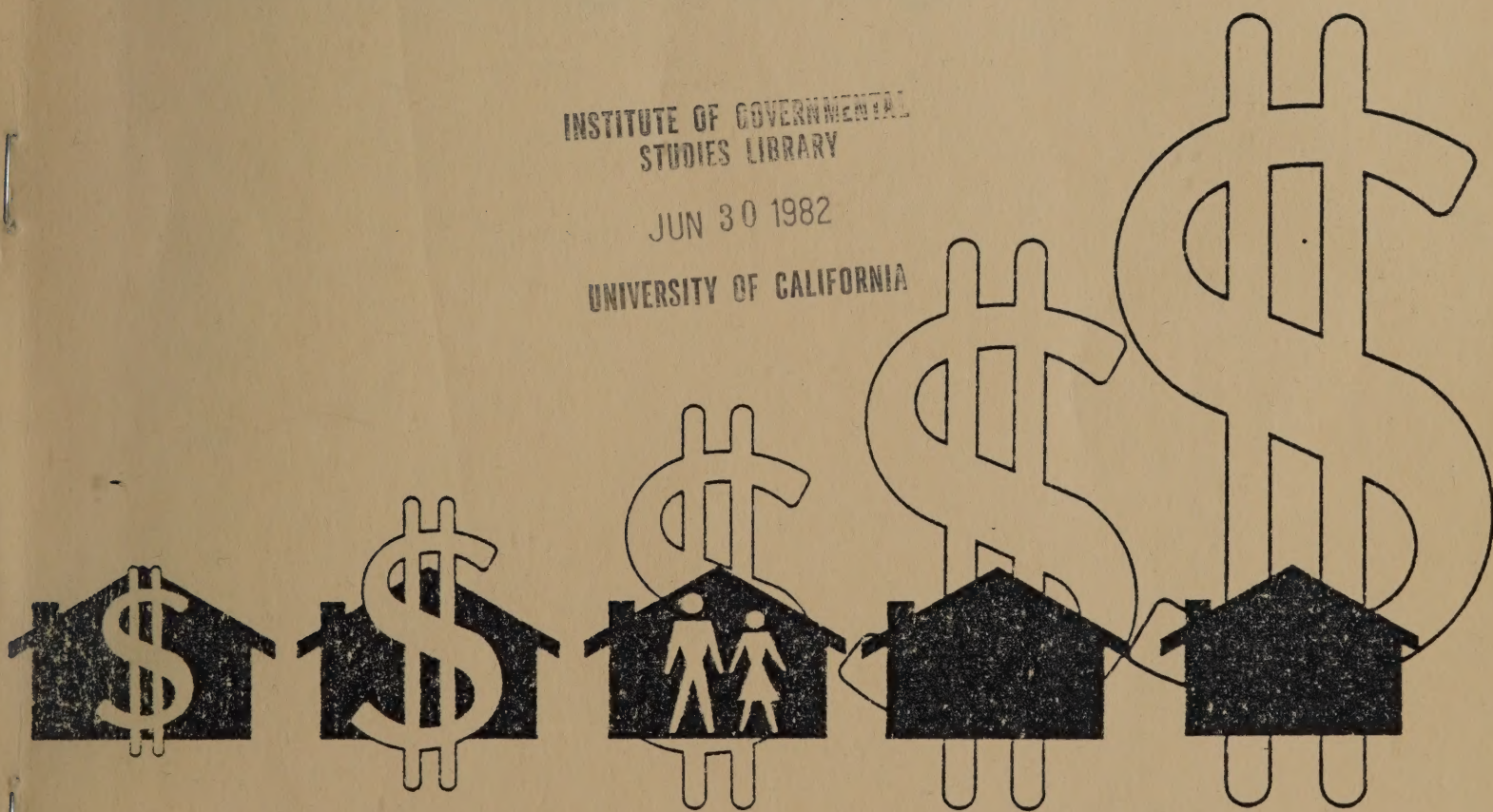


Costs, Causes and Consequences of the Housing Shortage

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Executive Summary

This report analyzes the cost, causes, and impacts of the housing shortage in Southern California. Its major points are summarized as follows:

Symptoms

- a) Market demands in the SCAG region are far outpacing our ability to supply new housing.
- b) Homeownership prices are rising at rates 2 to 3 times the rise in household incomes. In fact, monthly carrying costs for new homes have increased five-fold since 1970.
- c) Household demographic factors are further stimulating demand (e.g., numbers of persons per household, single-person households, divorce rates, etc.)
- d) A strong economic base is the primary stimulus and underlying force behind strong demand.
- e) Vacancy rates are at historically low levels.
- f) The present housing situation has impacted the economic base of Southern California in the following ways:
 - 1. Unaffordable home costs and interest rates mean direct loss of jobs in the housing construction industry.
 - 2. Because of home costs, California employers find it difficult to recruit personnel from other areas of the country.
 - 3. Employers must pay higher wages (or face rising pay demands) to compensate employees for the region's higher housing prices.
 - 4. Continual worsening of the jobs-to-housing balance within communities causes long commutes, automobile air pollution, more energy use, etc.
 - 5. There is a slowdown in the service sector and "growth-related" industries that depend on new housing additions.

Impacts and Implications

- a) New and first-time homebuyers are being frozen out of the ownership market. Last year only 15% of conventional home sales were to first time buyers.
- b) Low- and moderate-income households, and many middle-income households, are priced out of the homebuying market.
- c) Larger percentages of monthly incomes go to housing costs, thereby reducing moneys available for food, clothing, education, etc.

Underlying these symptoms of a housing market gone awry are many market forces that tend to distort or exacerbate the problem.

These include:

- a) For those who already owned a house, the rapid rise of prices created large stores of paper or actual equity. Since 1970, the return to equity has approximated 55% compounded annually.
- b) For those who can afford housing as an investment, high returns have fueled further inflationary expectations.
- c) The inflation in incomes has produced "income-tax-bracket creep"; the higher the bracket, the more tax savings investors realize from mortgage-interest and property-tax deductions, thereby effectively lowering the cost of owning a house (investment).
- d) Until the late 1970's, mortgage interest rates of thrift institutions were at or below inflation rates. Thus, the effective interest rate paid for housing, considering tax effects and appreciation, was negative. Single-family housing was thus an attractive investment.
- e) While those who can afford housing on a personal level are being induced to spend more than the standard rule-of-thumb for shelter (25% of total family income), national aggregate expenditures for housing (as a portion of all debt) have not increased disproportionately to other expenses.
- f) There have been high levels of foreign investment in Southern California, inflating the real estate market.

Underlying Causes

- 1) Lack of housing funds, and a volatile credit supply, have raised the price of mortgages to record highs. Government regulations (currently being phased out) on the thrift industry caused massive outflows of funds from primary housing lenders. Because of credit volatility, many lenders have stopped offering long-term funds to the housing sector.
- 2) Local controls that have reduced the housing supply or increased its costs are:
 - a) Lack of adequately zoned land available for development. Also, many areas are experiencing a surge in downzonings (reduction of permissible densities) due to neighborhood pressures.
 - b) "Minimum-lot sizes" so large as to preclude affordable units. Large-lot zoning also reduces unit yields per acre of land.
 - c) Larger or more expensive lots induce developers to produce more costly buildings.

- d) Current landowners or homeowners have a vested interest in maintaining "quality-of-life" or environmental regulations that slow down or stop housing growth. These regulations are "exclusionary" and tend to drive up prices of all currently owned property.
 - e) Subdivision regulations which are excessive or raise costs. These may:
 - 1) Mandate increased and/or excessive requirements (e.g., larger-than-necessary streets, excessive side lots, etc).
 - 2) Shift public service costs to the developer.
 - 3) Increase administrative, engineering, and planning costs.
 - f) Permit charges and in-lieu fees have risen dramatically since the passage of Prop. 13.
 - g) Environmental controls and impact statements tend to increase costs; more important, they delay projects for indeterminate periods of time, which makes realistic business decisions impossible, while inflation and credit charges drive up costs even further.
- 3) Indirect costs of regulations (by lessening competition) are:
- a) Developers who can make it through the regulatory process acquire monopoly powers over supply as competition is lessened.
 - b) Product cost rises, and there is a tendency to "load" products with extras (2-car garages, fireplaces, etc.)
 - c) Developers tend to build for the "top" of the market, maximizing their profits at the expense of volume.
 - d) Developers build at less than allowable densities.

Causes of Reduction in the Rental Market Supply

- 1) High interest costs.
- 2) Lack of multi-family or high-density zoning, which drives up the price of available zoned land.
- 3) The effects of 1976 federal tax-laws changes that reduced returns to investors (somewhat mitigated by tax law changes in 1981).
- 4) Incomes of renters have not kept pace with construction costs. For instance, a new two-bedroom non-luxury unit would have to rent for about \$1200 per month, requiring a tenant income of about \$57,600 a year.
- 5) Given today's costs, those with incomes adequate to pay rents that provide the landlord a comfortable rate of return usually find homeownership preferable because of current tax laws.

Effects of High Home Prices on Regional Economy

A staff estimate of the effects of increased costs of housing in Southern California found:

- a) If Southern California's median home price had remained equal to the national median, new homebuyers would have saved \$46 billion between 1975 and 1980.
- b) In a typical home-purchase transaction, the "add-ons" affected by the selling price would increase the \$46 billion figure by about 10%.
- c) As used-home prices are typically a function of new home prices and rise in some relationship to them, existing property owners' equity (inflationary benefits) rose an additional \$190 billion in Southern California.

These increased costs drastically affected demand and reduced the construction industry's contribution to the growth of our regional economy. While the loss of demand arising from decisions not to move to Southern California because of high housing prices cannot be known, a conservative estimate of \$10 billion in lost investment is made. This estimate is based on the amount of construction needed to achieve a "normal" vacancy rate (5%).

Trendline for the Future

While the current demand for housing is very soft due to tight credit, and price increases have slowed considerably, housing prices in the region for 1985 and 1990 are estimated as follows:

1985 - \$249,000 median-priced new home

1990 - \$500,000 median-priced new home

This estimate is based upon the rate of increase between 1970 and 1980.

While some may argue the absolute level of housing prices for the future, the trend is crystal clear: if restraints to growth are not lessened and economic growth continues, housing prices will continue to spiral upward. Obviously only the very rich will be able to afford new housing if this scenario continues into the future.

Political Implications

While it is hard to predict economic phenomena, political scenarios are even more difficult. Two current trends, spurred by tenants' need to protect themselves from inordinate price changes, are rent controls and condo conversion moratoriums. To the extent that "future" homeowners or renters do not vote in local matters, their political focus has been on state legislative actions. This has caused further intrusion into and erosion of the local political autonomy. As the effects of home prices

further slow the economic growth of the region, we can expect further pressure from the business and economic community to act on housing issues. Given the declining financial support from the state and federal government for housing production subsidies, these pressures on local governments will tend to increase.

Local governments will be forced to take a more active role in increasing housing production. This will mean "directing" actors in the development process to build the necessary housing, while providing the development "trade-offs" to induce that production to take place. This will entail more cooperation between the public and private sectors to achieve an adequate housing supply. The accompanying report on "Methods to Increase Housing Supply" for local governments will address this issue.

Rent Control

As noted above, this report views rent control as a consequence of the shortage of rental housing, rather than a primary cause. However, rent control, once instituted, does have a dampening effect on the construction of rental units.

I. INTRODUCTION

The Southern California Association of Governments (SCAG) covers a planning region encompassing Los Angeles, Orange, Ventura, Riverside, San Bernardino, and Imperial counties. Within this broad area, the demand for additional housing is estimated at 140,000 units a year.¹ In 1980, however, only 59,000 building permits were issued.² In addition, the regional vacancy rate has fallen from the normal 5% to an estimated 1.8%.³ This scarcity of available units is one cause of rising housing costs. The shortfall between the housing demanded and the housing available represents a major housing shortage.

This publication provides an overview and analysis of the direct and indirect forces affecting housing construction in the region. It attempts to explain, and to quantify where possible, the effects of the housing shortage on housing consumption and production, individual households, and social groups; and to show how housing supply, economic development, and environmental quality relate to and affect each other. The focus is on housing market factors specific to Southern California. National and international forces affecting monetary supply and federal tax and credit policies, while very important, are not examined here.

1 SCAG Regional Housing Element.

2 Security Pacific National Bank, Southern California Construction Trends.

3 Federal Home Loan Bank.

II. THE COSTS OF THE HOUSING SHORTAGE IN SOUTHERN CALIFORNIA

In the last quarter of 1980, the median price for a new single-family dwelling in Los Angeles County was \$124,500.¹ This median is up 13.7% from the third-quarter statistics (a \$15,000 appreciation in the median over that three-month period).² Condominium prices rose 15.8% in the same period, to a median sales price of \$104,000.³

In an overlapping three-month period (November and December of 1980 and January of 1981), there was a 43% to 45% drop in the sales of condos and single family houses.⁴

One conclusion that may be drawn from these figures is that the Los Angeles County demand for housing is so great that falling sales may not cause prices to drop. However, any careful analysis of prices must distinguish between two housing cycles. In the first, from 1975 to early 1980, demand was so strong that prices rose at record levels year by year. In the second, from 1980 to the present, prices softened considerably, although reported average sales prices have continued to increase at a 10% rate.⁵ Some caution in data interpretation is needed here. First, total sales volumes have dropped appreciably.⁶ Second, the sales that are being reported contain subsidies internal to the sales, which in real terms means a price less than the accepted sales price. (For example, many sellers are "taking back" second or third mortgages without principal or interest payments. Or the seller may take a second back and immediately re-sell the note at a 20% discount to a company specializing in such notes.)

Thus, despite the drop in sales, demand has really not slackened much; but high costs and the scarcity of credit have diminished buying capacity.

The Nature and Depth of the Shortage - Demographics

The need for housing is intensified by population growth, both from migration and natural increase, rate and type of household formation, changes in household size, and other demographic factors. Between 1970 and 1980, California's population increased by 17.7%, or 3,539,870 persons. The SCAG region grew by 14.56%, adding 1,464,268 residents to the six-county area. The region's population growth was 41% of state-wide growth.⁷

¹ Kinchen, David M. "Median Home Prices Despite Slump," Los Angeles Times, January 25, 1981.

² Ibid.

³ Ibid.

⁴ Ibid.

⁵ Calif. Association of Realtors, Calif. Real Estate Trends Newsletter, June 1981.

⁶ Ibid.

⁷ SCAG-78 - Development Guide Forecasts.

This growth is disproportionately high in households in the 20- to 35-year age bracket. The World War II "baby boom generation" has come of age as home purchasers and renters. The California Department of Finance confirms that the number of persons aged 20 to 35 rose by 21% from 1970 to 1975, and by an additional 12% from 1975 to 1980. The increase in householders of this age has been likened to the image of a boa constrictor ingesting a watermelon.¹ This group creates a temporary, though urgent, need for housing units that will carry through into the 1990's.

Household characteristics of the general population also are changing. In California, the average household dropped from 3.35 persons in 1950 to 2.65 in 1980. Among the reasons for this trend to smaller households (which causes an increased demand for discrete units) are the high incidence of divorce, number of single-person and single-parent households, and senior citizen housing needs. The California Association of Realtors reports that the decline in household size alone engenders a 20.8% increase in housing demand.

The tremendous rise in families where both adults work outside the home also has affected housing demand. Lenders have become willing to issue long-term mortgages whose repayment is based on two incomes. Builders consider total family income in providing middle-class housing with an inflationary price tag. Even graduated-payment mortgages assume that upwardly mobile young families will have the means and inclination to make increasing payments for the privilege of owning a home.

Migration into the sunbelt states has also raised housing demand. The Council for the 80's, in making recommendations for growth, followed trend by favoring further migration from eastern states to the sunbelt. Southern California is also heavily impacted by an influx of aliens, including refugees. The healthy industrial climate of California makes it an attractive target for job-seekers.

An additional problem in satisfying today's housing needs is the requirement to provide a broader range of housing types -- accommodating single young adults, family, small family elderly, etc. The rising percentage of smaller households indicates the region's need for more units suitable to one- and two-person households.

¹ Alonzo, William. The Population Factor and Urban Structure: Cambridge: Harvard Center for Population Studies, 1977.

The Demand for Housing

The chart below converts selected household demand factors into estimates of housing need for the SCAG region. The total production shortfall over four of the past five years is estimated to be 115,014, or an average annual shortfall of 28,753 units.

Table 1. HOUSING DEMAND PROJECTIONS

| | <u>1976</u> | <u>1977</u> | <u>1978</u> | <u>1979</u> | : | <u>1980</u> |
|--------------------------------|-------------|-------------|-------------|-------------|----------------------|-------------|
| Population ¹ | 10,474,000 | 10,634,800 | 10,795,600 | 10,998,046 | : | 11,215,000 |
| Household Size ² | 2.734 | 2.720 | 2.692 | 2.673 | : | 2.648 |
| <hr/> | | | | | | |
| TOTAL HOUSEHOLDS | 3,831,000 | 3,909,850 | 4,010,250 | 4,114,500 | : | 4,235,270 |
| | : | : | : | : | : | : |
| New Households (Net Change) | 078,850 | 100,400 | 104,250 | 120,770 | : | |
| Vacancies @ 4.0%* | 3,154 | 4,016 | 4,170 | 4,830 | | |
| Demolitions @ .005 Rate* | 21,500 | 21,500 | 21,500 | 21,500 | | |
| <hr/> | | | | | | |
| HOUSING NEEDS | 103,504 | 125,916 | 130,520 | 147,100* | (126,760 4-yr. Avg.) | |
| Regional Building Permits | 88,747 | 110,812 | 102,367 | 90,100 | (098,007 4-yr. Avg.) | |
| <hr/> | | | | | | |
| SHORTFALL | 14,757 | 15,104 | 28,153 | 57,000 | (028,753 4-yr. Avg.) | |

* Does not include present shortfall of "pent-up" demand for prior years (about 107,500 units) or the difference between the present vacancy rate of 2% and an ideal rate of 5%.

¹ Population -- From SCAG '78, DOF, and interpolations of same.

² Department of Finance.

Another basis for projecting housing need is growth in employment. From 1976 to 1980, employment in Los Angeles, Orange, Riverside, San Bernardino and Ventura Counties increased by 917,400 jobs -- 229,350 jobs per year (Table II). SCAG statistics show that, over the long term, each new job adds about .8029 households. Thus, rising employment alone created an annual need for 184,100 more units. This compares favorably with the housing demand projections, when shortage backlogs and normal vacancy rates are added to housing demand.

Table II. NET INCREASE IN TOTAL EMPLOYMENT¹
(000's)

| County | 1976-77 | 1977-78 | 1978-79 | 1979-80 | Total Wage, Salary | Total Empl. | Average Employmt. Increase |
|--------------------------------------|---------|---------|---------|---------|-----------------------|----------------|----------------------------------|
| L. A. | 124.2 | 208.9 | 133.6 | 73.2 | 539.9 | 558.2 | 139.6 |
| Orange | 64.7 | 74.0 | 56.5 | 27.0 | 222.2 | 229.3 | 57.3 |
| S. B./ Riv. | 27.5 | 34.5 | 21.2 | 12.0 | 95.2 | 98.2 | 24.6 |
| Ventura | 10.5 | 10.4 | 6.6 | 3.2 | 30.7 | 31.7 | 7.9 |
| Total Wage & Salary Employment | 226.9 | 327.8 | 217.9 | 115.4 | 888.0 | -- | -- |
| Total Employment ² | 238.0 | 336.6 | 224.2 | 118.6 | -- | 917.4 | 229.3 |

Note: 1976-80 Average Annual Increase 229,300 x .8029 SCAG factor =
Change in Households of 184,100

Projections based on population and employment do not estimate housing need exactly, but they fall within a close range. The employment projections given here indicate the strength of Southern California's economic base, which is the dominant driving force behind current housing demand projections. It works in several ways:

- New jobs provide the capital for new household formations or further migration into the region.
- Higher wages or total aggregate income increases capital available for housing purchase or rental.

Except for the L.A. County figures, these estimates are close to the forecasts of the California Department of Housing and Community Development, (Table III).

¹ Real Estate Research Council of Southern California, 4th Qtr. - 1980 Regional Employment Increases.

² Includes self-employed, agricultural workers, etc.

In contrast to the Housing Demand Projections, building permit data indicate that about 90,000 building permits were issued in the counties making up the SCAG region in 1979. This satisfies only one half of the employment-based need and 75 percent of the forecast basic new construction need. However, the supply shortfall seems to be concentrated in areas outside of Riverside and San Bernardino Counties, as shown in Table III. If it is assumed that growth in housing should parallel job development, San Bernardino and Riverside counties appear to be oversupplying housing units. However, these counties appear to be evolving into "bedroom" communities for the job-growth areas in Orange County.

Table III. PERCENT OF HOUSING NEEDS MET IN 1979

| <u>County</u> | <u>State Forecast of Annual Need*</u> | <u>Employment Need Estimate</u> | <u>Building Permits</u> | <u>:: % of State :: Forecast</u> | <u>% of Employ- ment Need</u> |
|----------------|---|-------------------------------------|-----------------------------|--------------------------------------|-----------------------------------|
| Orange | 31,290 | 46,000 | 17,558 | :: 56 | 38 |
| Los Angeles | 57,480 | 112,000 | 38,085 | :: 66 | 34 |
| Ventura | 8,420 | 6,300 | 5,903 | :: 70 | 94 |
| Riverside | 10,820 | (| 13,186 | :: 122 | (|
| San Bernardino | 10,550 | (19,800 | 14,689 | :: 139 | (141 |
| Imperial | <u>2,000</u> | <u>--</u> | <u>679</u> | <u>:: 34</u> | <u>--</u> |
| | 120,560 | 184,100 | 90,100 | :: 75 | 49 |

* California Statewide Housing Plan, 1979

Note: The State forecast of Basic New Construction Needs is estimated on an annual rate for the period 1979-1983. It does not include units for the current vacancy shortfall or units needing replacement.

A downward trend in building permits issued began in 1977. Security Pacific Bank data (Table IV) show that the number of building permits issued declined by 8% from 1977 to 1978; by 12% from 1978 to 1979; and by 34% from 1979 to 1980. In 1980, only 59,232 building permits were issued. By county, the 1980 declines were registered as follows:

| | |
|----------------|------|
| San Bernardino | -44% |
| Riverside | -40% |
| Orange | -40% |
| Ventura | -30% |
| Los Angeles | -27% |
| Imperial | -16% |

In reference to the SCAG region's share of the State Annual New Construction Need, this trend lowered the 1980 percentage of need met from 75% to 49%. The percent of employment need met also fell, from 49% to 32%.

A downward trend in employment increases began in 1978, coincident with the fall in building permits. When building permits fell 8% from 1978 to 1979, regional employment was 3% below the four-year-average-increase figure of 229,000. When permits fell 34% from 1979 to 1980, the net change in employment was 48% below the average-increase figure. Thus the creation of new jobs seems to be linked to the level of building activity in the region.

These data indicate that the unmet demand is growing rapidly each year, and that the backlog of unmet demand is assuming great dimensions. The building slump also extended to San Bernardino and Riverside counties, and has further exacerbated the housing shortage in Orange and, to a lesser degree, the other counties in the region.

The building slump and its subregional (county) impacts raise some interesting questions about housing/job balance, growth, transportation, air quality, and other issues that merit further discussion. The adoption process for the SCAG-82 Growth Forecast Policy may provide a forum for these issues.

TABLE IV. ANNUAL BUILDING PERMITS ISSUED - SCAG REGION

| | <u>LOS ANGELES</u> <u>CO.</u> | <u>ORANGE</u> <u>CO.</u> | <u>RIVERSIDE</u> <u>CO.</u> | <u>SAN</u> <u>BERNARDINO CO.</u> | <u>VENTURA</u> <u>CO.</u> | <u>IMPERIAL</u> <u>CO.</u> | <u>REGIONAL</u> <u>TOTALS</u> |
|------|----------------------------------|-----------------------------|--------------------------------|-------------------------------------|------------------------------|-------------------------------|----------------------------------|
| 1970 | 46,553 | 23,408 | 4,865 | 5,010 | 5,115 | 340 | 85,291 |
| 1971 | 45,213 | 31,246 | 7,643 | 7,943 | 8,145 | 964 | 101,154 |
| 1972 | 53,100 | 35,664 | 10,193 | 9,920 | 7,451 | 794 | 117,122 |
| 1973 | 43,106 | 28,140 | 8,573 | 7,060 | 5,606 | 212 | 92,697 |
| 1974 | 20,346 | 18,011 | 4,027 | 4,107 | 2,696 | 200 | 49,387 |
| 1975 | 17,730 | 15,438 | 4,804 | 5,686 | 4,899 | 372 | 48,929 |
| 1976 | 29,286 | 30,516 | 9,361 | 10,476 | 8,537 | 571 | 88,747 |
| 1977 | 39,422 | 27,504 | 16,484 | 17,989 | 8,508 | 905 | 110,812 |
| 1978 | 40,537 | 19,631 | 14,153 | 18,937 | 8,215 | 894 | 102,367 |
| 1979 | 38,085 | 17,558 | 13,186 | 14,689 | 5,903 | 679 | 90,100 |
| 1980 | 27,883 | 10,545 | 7,871 | 8,237 | 4,125 | 571 | 59,232 |

11-YEAR AVERAGE: 85,985

5-YEAR AVERAGE: 90,251

Source: Security Pacific National Bank, Southern California Construction Trends.

The Effects on Renters

Many would-be home buyers can find adequate housing by renting. However, the vacancy rate in the SCAG region is 1.8% -- well below the 5% of a viable housing market. In rentals, as in homeownership, the shortage of housing imposes significant costs.

Rising rents are an example. Between 1970 and 1977, rents increased about 46% -- somewhat less than the overall cost of living, and about equal to the increase in incomes during the period. In 1978, 1979, and the first nine months of 1980, however, rents increased as rapidly as the cost of living, as shown in Table V.

Table V. Change in Cost of Living as Compared to Rental Prices¹

| | <u>Consumer Price Index</u> | <u>Percent Change</u> | <u>Rent Index</u> | <u>Percent Change</u> |
|---------------------|-------------------------------------|-----------------------|-----------------------|-----------------------|
| 1978 | 187.4 | 5.3% | 169.6 | 11.0% |
| 1979 | 205.0 | 9.3 | 180.5 | 6.4 |
| 1980 | 241.3 | 17.7 | 204.3 | 13.1 |
| Average Net Change: | | 10.7 | | 10.1 |

Rent increases have been spurred by rising operating expenses, particularly the spiraling costs of energy.² Rapid buying and selling of rental properties have also contributed. Rising prices and high interest rates mean larger costs in principal and interest, and increased costs of debt service must ultimately be met by higher rents.

The shortage in rental housing means that more households are paying a greater percentage of their income toward rent, and some households are grouping together to afford higher rents. Low-income households feel these effects most sharply. The costs of lost choice and mobility, being personal, are hard to quantify, but can lead to social stress and may even have regional environmental effects. For example, housing convenient to jobs may be unavailable, thereby causing longer commutes.

Constraints on the construction of rental housing prohibit a timely supply response to the need. The supply of rental units is eroded further by the conversion of apartments into condominiums.

Social and Personal Implications

One social implication of the housing shortage is clear: a declining percentage of people can afford to buy a home. First-time homebuyers have difficulty accumulating a down payment, and their incomes must be fairly high to cover principal and interest payments. A report by Alfred Gobar

¹ U. S. Bureau of Labor Statistics, L.A./Long Beach Area.

² Ibid.

and Associates on the Orange County housing market discusses the social dimension of high housing prices:

Family income patterns in Orange County are not totally independent of the cost of housing. Housing costs in Orange County may have been a cause of apparent rising incomes of County residents. Restricted availability of moderate priced housing in Orange County has inhibited moderate and low income families from residing in Orange County, causing the median income of actual residents to be higher than would otherwise be the case.

The shortage of housing in Southern California permits Orange County to "borrow" high income families supported by Los Angeles County's economy, and to "lend" middle and lower income families to lower housing cost areas outside the County. A comparison of housing prices with the potential income distribution would show an even greater disparity between home prices and incomes than is actually the case.¹

Gobar's analysis points out the diminution of housing choice and mobility for owners and renters alike. Some costs of an immobile housing market are difficult to quantify, such as "friction costs" -- the added time and expense of locating suitable units to rent or buy -- and opportunity costs, when people are forced to move to less expensive areas away from employment and service centers.

Housing shortages may have special effects on population subgroups, such as the elderly, minorities, and households with children. The elderly, with relatively fixed incomes, are very vulnerable to rapidly rising housing costs. For those with fixed or modest incomes, housing costs may reduce moneys needed for food, clothing, and medical care, as well as for entertainment and transportation. They are further affected as housing and land costs impact the commercial/retail enterprises they patronize.

Displacement is another potential effect of the housing shortage. Some people may be priced out of their neighborhoods by those able to pay more for housing. This process, called gentrification, has been documented in older neighborhoods in many cities. Gentrification is like condominium conversion in that some residents find themselves unable to afford their present shelter. Displacement hurts mostly persons of low and moderate income, and minorities and immigrants, whose housing options are already limited by high housing costs and discriminatory practices in the market place.

As noted in earlier sections, housing shortages can confer great market power on housing suppliers. When vacancy rates are very low, landlords can be selective in choosing tenants. Orange County's Fair Housing Council reports that more than 70% of rental units in the county will not accept families with young children. Families with teenagers reportedly cannot gain access to more than 80% of the rental stock. A report by the Fair Housing Project gives similar statistics. In four out of the five cities surveyed, families with children had access to less than 25% of the rental stock.

¹ Gobar, Op. Cit., P.11.

III. EFFECTS ON CONSUMERS

The ways in which high housing prices and costs affect individual households vary markedly with income, current housing status, and stored wealth or equity.

Prices

Table VI shows average home prices in 1970 and 1980 for counties in the SCAG region. Since 1970, average home prices in Southern California have increased 308%, and since 1975 they have increased by 165%. The consumer price index for the Los Angeles/ Anaheim metropolitan area from 1975 to 1979 rose by 35.6%, while the median income in Los Angeles County rose by 50.1%. The disparity between incomes and housing prices means that a declining percentage of the population can buy a house.

A recent SCAG study shows that in 1970, half the homes in California were of a price range affordable by a family earning \$10,000.¹ The equivalent family in 1977 earned \$15,000, but homes they could afford made up only 14% percent of the housing stock. A middle-income family earning \$15,000 in 1970 could afford 84% of all housing; the same family in 1977 earned \$22,000 but could afford only 55% of available housing. Thus, about 1-1/2 million families who could buy a home in 1970 cannot do so today. This includes households who could not buy their homes if they had to buy them at current prices.²

These figures do not provide for increases in interest rates, property taxes, or insurance. When such costs are considered, the impact of rising prices is even more dramatic. Required down payments (usually 20% percent of the purchase price) escalate. While average prices in Southern California rose from \$30,400 in October, 1970, to \$124,100 in October, 1980, the average down payment (assuming a 20 percent loan to value ratio) rose from \$6,080 to \$24,820. Other costs pegged to the price of the house, such as real estate broker commissions, title insurance, property taxes and closing costs, have increased as well.

The income needed to buy the average-priced home in 1980 is about double the median income of the residents of the SCAG region. As a result, most homes today are bought by households who already own a home and are trading up. A study by the U.S. League of Savings and Loan Associations shows that 85% of all homes purchased last year were bought by current homeowners.³ First-time homebuyers (e.g., renters) are, for the most part, priced out of the housing market.

¹ SCAG Regional Housing Element, 1979.

² Ibid.

³ U. S. League of Savings and Loan Associations, "Homeownership; Coping with Inflation," 1980.

Table VI. Average Home Prices¹

| | <u>L.A. Co.</u> | <u>Orange Co.</u> | <u>Riverside/ S. Bernardino</u> | <u>Ventura/ Santa Barbara</u> |
|------|-----------------|-------------------|-------------------------------------|-----------------------------------|
| 1970 | \$ 34,200 | \$ 27,000 | \$ 22,100 | \$ 24,300 |
| 1975 | 50,700 | 44,300 | 31,100 | 37,300 |
| 1980 | 142,500 | 107,100 | 77,200 | 101,500 |

Information not available for Imperial Co.

Table VII. Median Income²

| <u>County</u> | <u>1974</u> | <u>1980</u> | <u>Percent Increase 1974-1980</u> |
|------------------------------|-------------|-------------|---|
| Los Angeles | \$14,190 | \$21,300 | 50.1% |
| Orange County | 15,595 | 23,000 | 47.5 |
| Riverside/ San Bernardino | 11,909 | 17,300 | 45.2 |
| Ventura | 14,555 | 21,800 | 49.7 |
| Imperial | 10,746 | 15,700 | 46.1 |

¹ Real Estate Research Council of Southern California, 3rd Qtr. 1980. P. 29.

² U. S. Department of HUD, EMAD.

³ RERC, Op. Cit., and HUD-EMAD-L.A. Office.

The following chart shows the monthly payments for the average-price home, assuming a 20% down payment.

Table VIII.

| | <u>Price</u> | <u>Down Payment</u> | <u>Interest Rates</u> | <u>Monthly Payment</u> |
|-------|--------------|-------------------------|---------------------------|----------------------------|
| 1970 | \$ 30,800 | \$ 6,160 | \$ 8.93 | \$ 197.02 |
| 1972 | 33,200 | 6,640 | 7.50 | 185.71 |
| 1974 | 40,700 | 8,140 | 9.61 | 225.47 |
| 1976 | 57,200 | 11,440 | 9.32 | 378.78 |
| 1978 | 91,500 | 18,300 | 9.91 | 637.52 |
| 1980* | 124,100 | 24,820 | 13.08* | 1,104.45 |

* Average through Sept., 1980

Average monthly carrying costs have increased five-fold since 1974.

Assuming that monthly mortgage costs are about 30% of monthly income, extrapolation shows the annual income needed to purchase the average-price homes noted in the chart above:

Table IX.

| | <u>Income Required</u> | <u>Mortgage Price Index</u> | <u>Interest Rate Index</u> | <u>Monthly Mortgage Payment Index</u> |
|------|----------------------------|-------------------------------------|------------------------------------|---|
| 1970 | \$ 7,880 | 100.00 | 100.00 | 100.00 |
| 1972 | 7,428 | 107.79 | 84.00 | 92.26 |
| 1974 | 9,019 | 132.14 | 107.61 | 114.44 |
| 1976 | 15,151 | 185.71 | 104.37 | 192.25 |
| 1978 | 25,500 | 297.08 | 110.97 | 323.58 |
| 1980 | 44,162 | 402.92 | 146.47 | 560.58 |

Impacts Upon Households

Almost no one of low or moderate income can buy a home. Rising numbers of middle- and upper-income households face the same problem, although they can often pay more for housing without cutting back on food, clothes, medical care, or child care. The housing problem is even worse for young families and households coming into the housing market. Many will have to rent rather than buy.

For those who already own homes or can afford to buy, the rapid rise in home prices has made homeownership very profitable. A household that bought an average-price house in Orange County in 1972 and sold it for the average price in 1978 would have enjoyed a capital gain of \$98,677.²

¹ RERC, Op. Cit., pp. 30, 38.

² Gobar, Op. Cit.

If the original down payment was 20% of the purchase price, the average annual compound rate of return to equity would approximate 55% compounded annually. The annual rate of appreciation was 25% compounded. The returns of homeownership in Southern California have usually exceeded the returns in almost any investment, including oil, diamonds, and gold.

The high returns caused by the housing shortage have added fuel to an already hot market. Anthony Downs writes, "Ironically, rising home prices have not curtailed the number of units demanded, as economic theory would predict. Rather they have increased the number by stimulating greater total demand by people who expect additional price increases."¹

Another impact involves the lenders' formula for setting the percentage of income that can be reasonably relied upon for debt repayment. Formerly, the maximum allowed for house payment was 25% of family income. Today, the maximum may be as high as 33% of total income. The investor-owner concept of home ownership has greatly affected the attitudes of financial institutions.

Price Expectations

Consumer behavior in today's housing market is influenced by the inflation felt throughout the economy in recent years, the expectation of rising prices, and the reduction in federal income taxes allowed for mortgage interest.

Economists have found that price expectations help to inflate prices. If investors believe that prices will rise at rates comparable to those of the past, they incorporate that belief into their investment calculations. A study by Leo Grebler and Frank Mittlebach, which attempts to quantify the impacts of expectations on house price, found that past rates of increase in home prices did much to explain later price increases.²

Influence of the Federal Income Tax Structure

Mortgage interest payments and property taxes can be deducted from federal income taxes. Homeowner tax benefits are, in fact, the largest federal housing subsidy. Homeowner deductions will be about \$35 billion in 1981, whereas direct outlays for federally subsidized low-income housing will be only \$7.4 billion.³

The total deductibility of mortgage interest on owner-occupied homes for 1981 in the United States amounts to \$19.8 billion. Property tax deductions came to \$8.9 billion, deferred capital gains tax on house sales ran \$1.1 billion, and exclusion of capital gains for persons over age 55 (these homeowners are excluded from capital gains tax one time only when they sell their primary domicile after age 55) is an estimated \$590 million. In addition, there were other homeowner tax subsidies.

¹ Brookings, V17, #1, Summer 1980, P.2.

² Grebler and Mittlebach, "The Inflation of Housing Prices."

³ Housing & Development Reporter. "Tax Expenditures Provide Bulk of Government Housing Aid, Says Treasury", p.865, 3-16-81.

Nominal median household income in Southern California rose 71.3% between 1970 and 1978. While inflation eroded the purchasing power of rising incomes because of the progressive tax structure, tax liabilities also rose. Generally speaking, the higher the income or tax bracket, the more tax savings are possible through mortgage-interest and property-tax deductions.

Table X shows the effective after-tax interest rate paid at different tax bracket or income levels. Thus, a household earning \$35,000 a year with a 14% mortgage actually pays an effective interest rate of 7.28% toward debt service after allowable tax deductions are taken. On the other hand, a household earning \$20,000 a year with a 14% mortgage pays, on an adjusted basis, 9.8%.

TABLE X. EFFECTIVE AFTER-TAX INTEREST RATES

| INCOME TAX BRACKET | | | | | |
|-----------------------|----------|------|-------|-------|-------|
| FROM | TO | 12% | 14% | 16% | 18% |
| \$14,650 | \$16,000 | 8.88 | 10.36 | 11.84 | 13.32 |
| 16,000 | 18,050 | 8.52 | 9.94 | 11.36 | 12.78 |
| 18,050 | 20,200 | 8.40 | 9.80 | 11.20 | 12.60 |
| 20,200 | 21,450 | 7.92 | 9.24 | 10.56 | 11.88 |
| 21,450 | 24,600 | 7.80 | 9.10 | 10.40 | 11.70 |
| 24,600 | 24,750 | 7.32 | 8.54 | 9.76 | 10.98 |
| 24,750 | 28,150 | 7.20 | 8.40 | 9.60 | 10.80 |
| 28,150 | 29,900 | 7.08 | 8.26 | 9.44 | 10.62 |
| 29,900 | 31,500 | 6.48 | 7.56 | 8.64 | 9.72 |
| 31,550 | 34,950 | 6.36 | 7.42 | 8.48 | 9.54 |
| 34,950 | 35,200 | 6.24 | 7.28 | 8.32 | 9.36 |
| 35,200 | 45,800 | 5.52 | 6.44 | 7.36 | 8.28 |
| 45,800 | 60,000 | 4.80 | 5.60 | 6.40 | 7.20 |
| 60,000 | 85,600 | 4.20 | 4.90 | 5.60 | 6.30 |
| 85,600 | 109,400 | 3.60 | 4.20 | 4.80 | 5.40 |
| 109,400 | 162,400 | 3.00 | 3.50 | 4.00 | 4.50 |
| 162,400 | 215,400 | 2.52 | 2.94 | 3.36 | 3.78 |
| 215,400+ | | 2.28 | 2.66 | 3.04 | 3.42 |

The following chart from The Los Angeles Times Real Estate Section indicates the monthly payment differences between households in the 20%, 30%, 40% and 50% tax brackets, after state and federal income taxes, for homes purchased at the same price, interest rate and loan amount.

TABLE XI

CALIFORNIA SAMPLE HOME REPAYMENT SCHEDULES

BASED ON CONVENTIONAL, FIXED-RATE, 80% LOAN AMORTIZED FOR 30 YEARS

| <u>Year</u> | <u>Avg. Sales Price</u> | <u>Eff. Int. Rate</u> | <u>Loan Amount</u> | <u>First Monthly Payment</u> | | <u>Monthly Payment After State & Federal Income Taxes by Tax Bracket</u> | | | |
|-------------|---------------------------------|-------------------------------|------------------------|----------------------------------|--------------------------|--|------------|------------|------------|
| | | | | <u>Prin. & Int.</u> | <u>Interest Only</u> | <u>20%</u> | <u>30%</u> | <u>40%</u> | <u>50%</u> |
| 1970 | \$36,536 | 8.54% | \$29,229 | \$225.57 | \$208.00 | \$183.97 | \$163.17 | \$142.37 | \$121.57 |
| 1971 | 36,375 | 7.69 | 29,100 | 207.19 | 186.38 | 169.91 | 151.27 | 132.64 | 114.00 |
| 1972 | 37,764 | 7.55 | 30,211 | 212.21 | 190.00 | 174.21 | 155.21 | 136.21 | 117.21 |
| 1973 | 40,961 | 8.92 | 32,769 | 261.86 | 243.68 | 213.13 | 188.76 | 164.39 | 140.03 |
| 1974 | 48,519 | 10.17 | 38,815 | 345.62 | 329.07 | 279.80 | 246.90 | 213.99 | 181.08 |
| 1975 | 54,132 | 9.53 | 43,306 | 365.20 | 344.04 | 296.39 | 261.98 | 227.58 | 193.17 |
| 1976 | 62,392 | 9.41 | 49,914 | 416.43 | 391.41 | 338.15 | 299.01 | 259.87 | 220.73 |
| 1977 | 76,621 | 9.34 | 59,696 | 494.86 | 464.47 | 401.97 | 355.52 | 309.08 | 262.63 |
| 1978 | 90,284 | 10.18 | 72,227 | 643.66 | 612.93 | 521.07 | 459.78 | 398.48 | 337.19 |
| 1979 | 101,411 | 12.19 | 81,128 | 846.39 | 824.13 | 681.56 | 599.15 | 516.73 | 434.32 |
| 1980 | 116,300 | 12.54 | 93,040 | 995.87 | 972.27 | 801.41 | 704.18 | 606.96 | 509.73 |

Sources: Federal Home Loan Bank Board, Security Pacific National Bank

On an after-tax basis, monthly housing costs remain high, but tax benefits do temper the bite of today's interest rates. Thus, federal and state tax benefits moderate the prohibitive interest rates, which might otherwise cool housing demand. When tax effects are coupled with appreciation, the real cost of borrowed funds may be negative. Anthony Downs explains:

An effect of inflation is to reduce the real after-tax rate of interest paid by borrowers in constantly devalued dollars. Another simplified calculation will make this clear. If a borrower pays 12 percent interest on a mortgage when prices are rising 10 percent a year, the real rate of interest is 1.8 percent before taxes for the first year (1.12 divided by 1.10). The rate falls to minus 2.5 percent after taxes for people in the 40 percent tax bracket. And if the house itself is rising in value at 12.7 percent a year, as it has on the average for the entire nation in recent years, then even the before-tax rate is negative and the after-tax rate is minus 4.8 percent.¹

These tax inflation effects can best be explained by the following:

Nonetheless, the distortion by inflation on housing patterns is arbitrary and thus unlikely to be socially optimal. In addition, the distortion is not confined to choices within the housing market. The combination of inflation and special tax treatment tends to alter relative rates of return within housing, and also between housing and other assets in the economy. (In terms of tax treatment, incidentally, a landlord's housing investment is analogous to investment in general.) Thus, capital that otherwise would have flowed into industrial uses frequently has been attracted to housing instead. Trends in the composition of household portfolios verify a dramatic shift by households out of financial assets (including corporate equities) into housing assets. Thus the true "crisis" may be that too much -- rather than too little -- housing is produced and consumed in our economy.²

It is important to differentiate between previous owners and first-time buyers in this analysis.

Thus, while households who can afford to be in the market may be investing too much on an individual basis, the overall percentage of capital invested in housing over the past 30 years has not increased dramatically.

¹ Brookings Institute, Op. Cit.

² Randall Pozdena, "Inflation Expectations and The Housing Market" Federal Reserve Bank-Economic Review-Fall 1980.

Differences in Consumer and National Investments in Housing

The Journal of Housing recently reported that the amount of money that Americans invest in housing as a percent of gross national product is second lowest only to Britain among major industrialized countries. The total amount of credit used by Americans has increased dramatically in the past 40 years. However, the percentage of borrowed capital going to housing among major borrowing sectors has not increased significantly over the past 30 years, while the federal portion of borrowings has increased sharply.¹

It seems that overall residential investment and borrowing may not be disproportionate, while it may be so at the level of individual households. Federal fiscal and tax policies on housing currently provide incentives for the wealthy to invest in second homes and extra-large houses. These tax benefits are paid for by all, including the "have nots", toward whom housing policies should be made more sensitive.

The vigor of a locality's economic base arises from a balance of employment, commercial/industrial, and residential sectors. Ideally, residents should have access to jobs and needed consumer services within the geographic boundaries of the community. "No growth" policies that allow more industry while discouraging housing construction, for example, tamper with the balance and may harm a locality's economy. Lack of housing within a reasonable commuting distance can inflate the prices of the existing housing stock and, eventually, discourage new industrial and retail development. Foreign investments in property also inflate values in some markets.

Foreign Investments

Political and monetary instability throughout the world has made American property a safe and profitable long-term investment. European and Asian investors buy up and hold real property without concern for short-term profits, often paying much more than comparable market prices, and thus drive up prices.

In some communities, prices far exceed what seems reasonable to local investors and local governments, and ways to lessen the inflationary effect of foreign speculation have been sought. One community developed a formula that requires equally-valued structures to become equal in condition. For example, if a speculator bought for \$250,000 a property that had a fair market value of \$175,000, the structure would have to be upgraded in appointments to the degree that it was comparable in appearance and functional utility to other buildings with a fair market value of \$250,000. This has the desired effect of maintaining a viable, balanced economic base without dictating policy.

¹ Arthur P. Soloman, "Flawed Analyses of Market Trends Fuels Assaults on Housing Expenditures", Journal of Housing, April 1981.

IV. THE SUPPLY RESPONSE

While Southern California's annual need for has risen steadily, housing production has lagged. Annual housing production has averaged 88,500 units over the last eight-year period. This has spurred rapid increases in housing costs in recent years.

Many factors have lessened builders' ability to respond to the surge in housing demand. There are systemic, non-local constraints on housing production, such as volatility of capital markets and building-material shortages. On the local level, land-use policies and regulations (such as zoning ordinances and growth controls) work to diminish the number of units built and to raise production costs as well.

Volatility of Credit

The housing industry is very sensitive to changes in the availability of money and the and cost of borrowing it. Both housing production and final purchases are highly leveraged investments; thus, a consistent supply of financing dollars is needed to encourage builders to build and buyers to buy. The influence of the macro-economy on housing production is examined in a recent publication by Security Pacific National Bank:

Despite consistent unmet need for new housing, additions to the housing supply have been determined primarily by other economic factors throughout most of the decade. In 1970, more than 195,600 new dwelling units were authorized for construction by building permits in California. Home building peaked at 279,700 new units in 1972 before suffering a setback as the economy entered the 1974-75 recession. Housing production then hit a recession low of 129,000 units and climbed throughout the next two years, peaking at over 270,600 new units in 1977.

Economic uncertainties contributed to another homebuilding downturn in 1978 and 1979. The 210,000 units authorized for construction in 1979 represented only a slight increase over the number of units included in building permits at the beginning of the decade. In the first eight months of 1980, the state's credit-sensitive homebuilding industry produced only 90,071 new dwelling units, 38 percent below the comparable 1979 amount. High interest rates and an inadequate supply of funds were the primary factors behind this decline.¹

Conservative estimates are that, statewide, California needed between 250,000 and 290,000 new units per year during the last decade to keep pace with new household formations and immigration levels and to replace deteriorating housing stock. New housing production exceeded 250,000 units in only three of the last ten years, leaving a statewide shortfall of some 500,000 units during the decade.

¹ Security Pacific National Bank, "California Housing Affordability", 1980.

Credit Costs and Availability

Since credit cycles vitally influence housing production and purchase, federal housing policy since the 1930's has focused on providing a sufficient and consistent flow of capital for housing. Among these efforts are the development of FHA insurance, the creation of secondary mortgage markets and mortgage-backed securities, and the adoption of regulations governing financial institutions. These and other policies supported the familiar long-term, fixed-interest, fully amortized level payment mortgage system.

Savings and loan institutions (S & L's) have long been the predominant residential mortgage lenders. Recently, however, funds once deposited with S & L's have been finding their way to higher yielding savings/investment alternatives. Although the creation of high-yield, short-term Money Market Certificates (MMC's) and certificates of deposit in the 1970's enabled S & L's to better compete for funds during periods of high demand for credit, it was at a higher cost. In addition, the volatility of interest rates along with inflation has diminished the attractiveness of long term fixed interest instruments, further eroding the future of the mortgage as we now know it. The mismatch of maturities between traditional assets (mortgages) and liabilities (deposits) is yet another problem to be resolved in the housing finance sector. These technical issues appear to underlie the insufficient levels of finance, or high interest costs of the past decade.

In response to these problems, Congress has taken steps to modify some regulations on financial institutions so as to smooth out the fluctuations in financial markets. In addition, alternative mortgage instruments, such as variable-rate, renegotiable-rate, and roll-over mortgages, have been developed. These instruments, discussed more fully in another SCAG report, (See SCAG's "Methods to Increase the Housing Supply") may be more responsive to the volatility in capital markets than the fixed-rate, long-term mortgages prevalent today. The deregulation of S & L's may mean that funds for housing may be more consistently available, but at a higher cost. Likewise, variable-rate and other alternative mortgage instruments may make mortgage money more accessible to consumers, again at a higher cost. As an interim measure to supply housing funds in the present period of high interest rates, sellers are offering to provide short-term loans and other creative financing packages to buyers who can not qualify for a mortgage that makes up the difference between the down payment and the selling price.

Constraints at the Local Level

A locality's geo-physical boundaries may constrain its growth. Barriers such as the ocean, hillsides, and other natural features may preclude development or require special planning methods to overcome them. Local, state and federal land-use and environmental regulations also influence both the supply and cost of housing at the local level.

Land-use regulations may increase housing prices both directly and indirectly. Direct costs are all the costs of compliance, i.e., meeting land-use intensity and structural standards, consulting and engineering expenses, fees, as well as landholding charges accrued in the development approval process. Indirect impacts of regulation include reduced competition among housing suppliers and the tendency to tailor projects to the upper end of the market. The possible effects of zoning and subdivision ordinances as well as other land-use regulations are significant and merit discussion.

V. POLICIES THAT DIRECTLY INFLUENCE HOUSING SUPPLY AND COST

Zoning

Zoning law arose from "nuisance" doctrines designed to keep incompatible land uses separated, e.g., barring piggeries and slaughterhouses from residential neighborhoods. Zoning has also been used to preserve and enhance a neighborhood's physical and social character, and to influence a city's fiscal position.¹

Local zoning ordinances regulate the supply of land among alternative uses, and the intensity of use within zones. When zoning, urban limit lines, or permit-rationing programs restrict the supply of land available for a particular type of development, land costs are likely to increase.² Land-price increases caused by changes in residential zoning regulations are variously estimated from market to market, but studies document an upward trend.³ The mix of uses permitted by local zoning ordinances can also raise housing prices. For example, increasing the amount of land allocated for uses that generate employment may increase the demand for residential sites, as job centers create a demand for nearby housing.

Zoning ordinances also govern the intensity of residential land use. The following chart shows the percent of land allocated to various residential uses. Single-family detached homes account for more than 64% of the land zoned for residential use in the communities surveyed.

TABLE XII.
RESIDENTIAL ZONING BY TYPE OF USE⁴

| Housing Type | Percent Residential Land* |
|------------------------|---------------------------|
| Single-family Detached | 64.1% |
| Low-rise Multi-family | 24.7 |
| Mid-rise Multi-family | 7.2 |
| High-rise Multi-family | 2.6 |
| Other** | <u>1.4</u> |
| Total | 100.0% |

* Total residential-zoned land for 80 municipalities.

** Includes Mobile Home, PUD and other mixed-height or -use zones.

¹ Katz & Rosen. "The Effects of Land Use Controls on Housing Prices," Center for Real Estate & Urban Economics, Working Paper 80-13, 1980, p.4.

² Ohls, J.; Weisberg, R.; and White, M. "The Effect of Zoning on Land Value", Journal of Urban Economics 1 (1974), 428-44.

³ Witte, Ann. "An Examination of Various Elasticities for Residential Sites," Land Economics 53 (1977):401-409.

⁴ Center for Urban Policy Research. "Survey of Municipalities", Summer 1976.

The emphasis on single family zones may prohibit the savings on per-unit land costs that higher density development provides.

Minimum-lot-size requirements affect the development of affordable housing. Large-lot zoning limits the number of units on a parcel of land and thus affects overall supply; it also tends to increase land cost per unit as well. Seidel discusses these impacts in this passage:

Zoning creates sub-markets for the various residential lot sizes, and because of the municipal propensity for large lot zoning, the result is an oversupply of large lots and a shortage of small lots. The surfeit of large lots relative to demand causes a reduction in the price which large lots command. Further, the shortage of small lots places the few available lots at a premium, thus greatly increasing their per unit cost. Thus the effect is to facilitate large lot single family development, while at the same time impeding or at least increasing the cost of development of small lots.¹

The following table, reproduced from the recent analysis of land use regulations by Rosen and Katz, shows lot costs and housing prices for a number of states. Average lot costs in California far exceed averages in other states, and land cost per square foot is from two to six times that of other states. The divergence in average price per acre ranges from approximately \$73,000 to more than \$108,000. As the authors of this study comment, land costs comprise 27% of the value of new homes in California versus 18.7% nationally. Data from the Gobar and Associates' Study of Orange County for 1978 indicated that finished lots accounted for 35.3% of the sales price for a typical single family home.²

Because developers may attempt to achieve a ratio between the value of the land and the structure, high land costs may encourage additional construction costs.³ In addition, minimum floor-area requirements can increase construction and site-improvement costs, raising the final cost of the unit.

Studies have found that zoning can influence the price of existing housing as well as the costs of new housing.⁴ Thus, current owners want any future development kept subject to those zoning and land regulations that enhance the value of their homes. Bernard Frieden discusses this issue in the following passage from The Environmental Protection Hustle:⁵

¹ Center for Urban Policy Research. "Housing Costs and Governmental Regulations: Confronting One Regulatory Maze", Seidel, 1978.

² Alfred Gobar and Assoc. Housing Cost Analysis, Orange County, 1980.

³ Seidel, Op. Cit., p. 183.

⁴ Stull, William J., "Community Environment, Zoning, and the Value of single Family Homes," *Journal of Law and Economics* 18(1975):535557; and Peterson, George, "The Influence of Zoning Regulations on Land and Housing Prices." Washington, D.C., Urban Institute, 1974.

⁵ Frieden, Bernard J. The Environmental Protection Hustle, The MIT Press, 1979.

TABLE XIII.

LAND COSTS - 1979

| | Average Cost of Lot | Avg. Cost of Lot Per sq. Foot (Dollars) | Avg. Cost of Lot Per Acre (Dollars) | Average Size of Lot (Acres) | Avg. Cost of Farm Land Per Acre (Dollars) | Avg. Sales Price of House (Dollars) |
|-------------|---------------------------|--|--|--------------------------------------|---|--|
| | (1) | (2) | (3) | (4) | (5) | (6) |
| California | \$28,466 | \$2.96 | \$142,906 | .199 | \$ 844 | \$103,698 |
| Colorado | 12,613 | 1.44 | 69,750 | .181 | 297 | 71,034 |
| Florida | 12,049 | 1.13 | 54,477 | .22 | 838 | 58,277 |
| Georgia | 9,839 | .52 | 25,281 | .389 | 491 | 60,220 |
| Illinois | 16,484 | 1.57 | 76,029 | .217 | 1,484 | 83,270 |
| Michigan | 12,986 | .95 | 46,146 | .281 | 708 | 69,363 |
| Mississippi | 9,174 | .70 | 34,069 | .269 | 424 | 56,447 |
| Missouri | 10,427 | .89 | 43,065 | .242 | 560 | 68,756 |
| New Jersey | 16,486 | .98 | 47,204 | .341 | 1,884 | 71,019 |
| Texas | 9,689 | .96 | 46,245 | .209 | 320 | 63,474 |
| Virginia | 15,754 | 1.19 | 57,778 | .272 | 672 | 74,627 |

Source: Derived from Proprietary Builder Survey and Department of Agriculture: Farm Real Estate.

In the 1960s the victims of suburban exclusion were mainly poor people, a small and powerless minority. They are still victims of it in the 1970s. But now there are many more victims than before. Middle-income America, in addition to the poor, is now bearing the costs of suburban growth policies.

Frieden continues;

Why have suburbanities, who are overwhelmingly middle-class themselves, turned against other middle-class people who want to move into their communities? If California's experience is a guide, the fight is usually between families who have already made use of homeownership to improve their situation in life and other families trying to advance themselves by becoming suburban homeowners. Those who have already moved up the status ladder are enjoying a new lifestyle in comfortable suburbs, but they worry about how secure their gains are. Their fears seem to run as follows. First, growth might bring property tax increases that could threaten their ability to pay for the good lifestyle. Also, more homebuilding might crowd their schools and destroy the scenic qualities that give their property prestige and value. No matter that there is strong evidence against these fears, or that there are ways to manage growth while still keeping the desirable qualities of suburbia. People fight homebuilding even in the least threatened places, such as affluent Marin County with close to 500 square miles of open space. By joining local homeowner and environmental organizations, suburbanities can use political action to protect what they have. Although they themselves took full advantage of government policies that promoted homeownership for families of average income, they justify denying the same opportunities to others by calling it environmental protection.

Not to be overlooked are the pressures brought to bear upon local elected officials to support no-growth and low-density patterns. An active, visible coalition of community activists favoring limited growth can be a very powerful influence upon city policy decisions.

The change from keeping out the poor to keeping out the average family comes from a change of purpose. Earlier the goal was exclusion--keeping out people of lower status. Now the goal is freezing growth--keeping out everybody in order to maintain the status quo. Policies that freeze growth are a threat to families outside the suburbs who want to get in, but outsiders can do very little about these policies. They have no vote in the suburbs that exclude them, no organizations to join that will fight for their interests, and no persuasive rhetoric to use in local growth controversies.¹

¹ Frieden, Bernard J., Op. Cit.

Subdivision Regulations

Subdivision regulations, like zoning ordinances, can increase the housing production costs ultimately borne by consumers. Although they may contribute to the quality of neighborhoods, such ordinances can also create problems of affordability. Katz and Rosen identify three aspects of subdivision regulations that work to increase the cost of housing: 1) increased and/or excessive improvement requirements; 2) the shifting of public service costs to the developer; and 3) increased administrative, engineering, and planning costs.¹

Excessive subdivision requirements have long been cited as impediments to affordable housing. The Kaiser Commission Study² conducted 13 years ago reached this conclusion, as have later analyses. While there may sometimes be a fine line between requirements that promote public health and safety and those that are "excessive," Seidel found that many communities require overdesign in facilities such as streets and sewers. He also found that subdivision requirements tended to increase with the median income level of the community. He states, "the cost-increasing factor of excessive right-of-way widths would seem to be another device to raise the cost of development in exclusive municipalities."³

Overdesign of sewer, water, streets and other such systems in a specific project is one side of the cost analysis. Its opposite is failure to provide enough infrastructure to allow for new construction. Localities can limit the potential for growth when existing sewer or water facilities reach capacity and are not expanded to allow for new housing to be built.

The shifting of public service costs to private developers is closely related to the issues discussed above. Subdivision regulations requiring overdesign of streets or infrastructure force developers -- and ultimately consumers -- to shoulder the costs of services that benefit the entire community. At current interest rates, each dollar added to the cost of a unit will cost more than four dollars over the term of a mortgage. In California, Proposition 13's passage may bear some responsibility for the shift of costs from the public to the private sector.

Costs of development are also affected by planning policies that concern a city's geographical characteristics. Such things as hillside or ridgeline ordinances, intended to maintain the natural landscape, restrict expansion and housing development, as do open-space requirements.

¹ Katz and Rosen, Op. Cit.

² Middlebach and Burns. "Decent Home", Vol. II., Kaiser Commission, 1968.

³ Seidel, Op. Cit., P. 140.

Permit and In-Lieu Fees

Local fees for schools, utility hookups, permits, parks, and the like also raise housing production costs. A recent study in Orange County found that local in-lieu, processing, and hookup fees ranged from \$1,200 to more than \$7,000 per unit. The costs borne by consumers over the life of their mortgage would, therefore, range from \$4,806 to \$28,034, assuming permit fees of \$1,200 and \$7,000, respectively. Besides adding to monthly housing costs, other mechanisms of land-use policy such as fees and subdivision regulations operate to raise the costs of entry into the housing market. Permit fees alone could increase a household's required down payment by more than \$1,400 per unit.

Administrative Costs

The processing of development proposals to assure compliance with local, state, and federal regulations directly and indirectly increases development costs. Direct costs include the preparation of Environmental Impact Reports and other documents, undertaking mitigation measures, and landholding charges accrued during the administrative process. The length of the administrative process and rising interest rates operate to increase landholding costs. Alfred Gobar Associates, in their study of Orange County, estimate that financing costs increased at an annual rate of 34.45% between 1972 and 1978.¹ Another study estimates that compliance with the California Environmental Quality Act adds 4% to 7% to the selling price of new units.²

National data collected by Seidel shows that the administrative process increases the time from project start to finish. In 1970, almost 80% of the developers surveyed finished their projects within seven months. By 1975, he reports, only 27% completed their projects over a seven-month period. Developments taking more than three years to complete rose from .03% in 1970 to 8.7% in 1975. The land-development phase had become more time consuming than the actual building construction.³

A survey by the National Association of Realtors shows that California now has the most restrictive local government policies regarding housing construction.⁴ Jim Crowell, of the Building Industry Association of Southern California, says that most construction projects here take 17 to 32 months to get government approval, which increases new home costs as much as 26%.⁵

¹ Gobar and Associates, Op. Cit., p. 39

² Environmental Analysis Systems, Inc. "The California Environmental Quality Act," prepared for the State Assembly Committee on Local Governments, Sacramento, 1975.

³ Seidel, Op. Cit., p. 34.

⁴ Southern California Business, "Approval Process Causes Costly Delays," June 3, 1981, pg. 12.

⁵ Ibid.

Together, the direct costs of zoning, growth controls, subdivision requirements, and administration can account for great increases in the cost of producing housing. The number of approvals and permits required has increased development time for residential projects. Administrative delay can inflate the costs of the project, as financing charges accrue. Seidel estimates that project costs increase at a rate of 1% per month. For a \$100,000 home, this cost is \$1,000 per month, or \$12,000 per year. The real costs are astonishing when consumer financing charges are considered. A 12% increase in purchase price translates into a 48% increase in costs over the term of a mortgage!

The Indirect Costs of Regulations

Land use and environmental regulations also have indirect effects upon the price of housing. A recent article by David Dowall notes that indirect effects influence the cost of housing by altering housing producers' marketing and pricing decisions:

Regulation establishes monopoly power in a variety of ways. By restricting the supply of land available for development, the potential for market entry and the possibility of increased competition are reduced. If the supply of land is greatly reduced, housing producers may be better able to set housing prices above competitive levels.¹

The regulatory process confers monopoly power by restricting the entry of producers into the market place. Complex administrative procedures can raise the cost of building in a particular jurisdiction and may increase risks so as to discourage the participation of small or non-local firms. Builders familiar with local regulations will probably find it less costly and less risky to build. Generally, small firms are less able to manage the administrative process and increased capital requirements. If firms compete to sell their products, the higher ratio of buyers to sellers invites increasing the amenities of the basic product, again increasing costs. Alfred Gobar and Associates' report on Orange County notes that physical upgrading of the unit accounted for 20.32% of the increase in structural costs between 1972 and 1978. When the inflation on the upgrade is included, this component accounts for 36% of the increase in structural costs.²

¹ Dowall, David. "Land Use and Environmental Regulations," in Housing Policy for the 1980's, Montgomery and Marshall eds. Lexington, 1980 P.119.

² Gobar, Op. Cit., p. 34.

In the following passage, Dowall comments on the reasons for residential developments' reorientation to higher income consumers.

The second type of indirect effect of environmental regulations is the reorientation of residential projects. The previous discussion of monopoly power suggested that developers may increase prices in excess of increased costs owing to limited competition. There is, however, another reason for raising prices. Often developers find that if they raise prices to offset increased costs, the marketability of projects declines. Therefore, developers shift the orientation of projects to high-income consumers. Since profit is the result of per unit net revenue times the quantity of units sold, a shift in the design of the project to fewer higher-priced units often will result in higher profits. Development restrictions that limit residential density and increase production costs often force developers to scrap plans to produce high-volume projects and build exclusive high-priced projects. Routinely, land-use controls act to reduce the number of units produced to a level well below allowable limits as developers reorient their restricted projects to exclusive low-density development.¹

Industry professionals and researchers have noted the tendency to "load" the basic housing product. Sandy Sandling of the Warmington Group, responding to questions about inclusionary zoning, noted, "I've said for a long time that the building industry did not respond to the need for low cost housing. In '75-'76, the biggest game in town was building big, expensive units and they were marketing them as fast as they were building them. I've seen builders with an 18-unit-per-acre density on their property and, instead, they choose to build at the rate of four units per acre."² Bernard Frieden, author of The Environmental Protection Hustle, adds that public resistance to higher density and moderately priced developments has created a poor climate for producing enough housing to meet the needs of new households.

¹ Dowall, Op. Cit.

² L.A. Times, "Inclusionary Zoning Becomes Tidal Wave," Don Campbell. Sun Aug. 17, Part IX, Page 30.

VI. THE RENTAL MARKET

Much of the preceding discussion has focused on the dynamics of the single-family market, but both rental housing and owner-occupied housing are affected by high interest rates and local land-use policies. In fact, multi-family housing in general, and rental housing in particular, tend to generate the most controversy in the local land-use political arena.¹

Rental housing, as a percentage of all housing starts, has declined greatly. Nationwide, starts of apartments of five or more units fell from 29.2% of all unit starts in 1970 to 14.8% of all unit starts in 1979.² This is particularly unsettling in light of HUD's estimate that 75% of all multifamily construction, including condominiums, in 1979 was federally subsidized or federally insured.³

A number of issues underlie the decline in rental housing construction. Among the most important are changes in federal tax laws which limit tax benefits, rising construction costs, and high interest rates. These operate together to make new rental housing a very expensive product, particularly since the median income for renters is only 55% of the median income for homeowners.⁴ Those who can afford the rents required to sustain the development of new rental housing are likely, because of homeowner tax benefits and the effects of inflation, to find homeownership a more attractive package.

Tax Effects on Rental Housing

The Tax Reform Act of 1976 diminished the tax benefits formerly allowed for rental housing. Before the Act, construction-period interest and taxes could be written off in one year. Now, such items must be written off over five years; and in 1984, the law will be extended over a ten-year write-off period. Limitations have been placed on investment interest deductions, and exemptions from tax preference items have been reduced. Currently, there are several proposals in Congress to reinstate some of these incentives for rental development.

Previous loopholes which allowed investors to avoid recapture of depreciation deductions taken in excess of straight line have been closed. The cumulative effect of these and other tax reforms has been to make rental housing a less attractive investment by lowering the after-tax returns. While rental housing still has tax advantages over alternative investment vehicles, investors have a greater need to rely on "cash flow" returns than was previously the case.

¹ Frieden, Op. Cit.

² U.S. League of Savings Assns., 1980 Fact Book, p. 19, 20, 24.

³ GAO, "Rental Housing: A National Problem That Needs Attention," p.ii.

⁴ Ibid.

Construction Cost Increases

While tax benefits have been cut, construction costs have risen. The Marshall and Swift index for apartment construction shows that construction costs in the Los Angeles Area, for both low-rise and high-rise apartments, rose more than 150% between 1970 and 1980.¹ While this rise is only slightly in excess of cost increases for single-family units, the rentals required to provide the developer with an attractive return on investment, given prevailing interest rates, are exceedingly high.

In a Los Angeles Times article, Fred Case, Professor of Real Estate at UCLA's Graduate School of Management, illustrated this point. Assuming a 16% return on investment for an average-price apartment building in Los Angeles, today's income-property owner would have to rent a two-bedroom unit for \$1,200 a month to cover service plus return on the investment. The same two-bedroom, 900-sq.-ft. unit rented for \$265 per month in 1969. Applying the standard that housing costs should not exceed 25% of income, today's renter would need an annual salary of \$57,600 to afford today's average-price apartment.

This estimate suggests that the current required rents for newly developed multi-family rental housing either would suit only the luxury market or would require tenant subsidies. Lower income households would be hard pressed to pay the rentals, while higher income households would probably find home ownership more advantageous. George Sternlieb describes the situation as follows:

The inflation in housing costs for homeowners is essentially counterbalanced by a parallel inflation in real or conjectured capital values. In terms of cash-flow immediacies, homeowners -- particularly newcomers to the market -- seemingly are willing to devote unprecedented portions of their income to supporting housing acquisition. The alleviatory elements are nominally tax coverage and capital gains potential. Thus, when homeownership is employed as a leveraged investment, its support can be accepted quite realistically as the sum of both nominal shelter costs plus the surrogate quanta of funds that would once have gone into more traditional forms of investment -- private insurance, savings accounts, and the securities market.

The rental housing situation is quite different; there are no tax advantages to the tenancy; rents must be paid from post-tax income. Moreover, there is no compensatory investment element offsetting rents. The rental market and its soaring costs structures -- both in terms of development and operation -- must compete within an environment devoid of the incentives attached to homeownership.²

¹ Real Estate Research Council of Southern California, 3rd quarter 1980, p. 50.

² Sternlieb and J. Hughes, "The Uncertain Future of Rental Housing" in Housing Policy in the 1980's, Montgomery and Marshall, eds., Lexington, 1980 p. 80.

VII. THE EFFECTS OF THE SHORTAGE

Thus far, this paper has discussed the extent of the shortage and tried to identify the major constraints on supply. But the housing shortage in the SCAG region will also have social, political, economic, and environmental effects. The intent here is not to alarm, but rather to point out what the costs or impacts of an inadequate supply of housing really are.

The Economic Costs

As noted earlier, the average price of a house in Southern California exceeds the national average by more than \$49,100. Until 1974, the local and national averages were fairly close; since then the disparity has grown annually. Taking the national average as an equilibrium price (since inflation and high interest rates have been felt throughout the nation), it is possible to measure roughly the cost of Southern California's shortage. By multiplying the average number of home sales by the price differential on a year-by-year basis from 1974 to 1980, it is possible to estimate the projected additional costs to Southern California homebuyers as follows:

TABLE XIV

| | <u>Price Differential</u> | <u>So. Calif. No. of Homes Sold*</u> | <u>Total Additional Costs to Southern Californians</u> |
|-----------|-------------------------------|--|--|
| 1975 | \$ 1,700 | 324,650 | \$ 551,905,000 |
| 1976 | 6,500 | 401,953 | 2,612,694,500 |
| 1977 | 15,300 | 460,123 | 7,039,881,900 |
| 1978 | 27,100 | 446,610 | 12,103,131,000 |
| 1979 | 35,800 | 456,544 | 16,344,275,200 |
| 1980 | 47,700 | 381,853 | 18,143,881,000 |
| (1st Qtr) | | TOTAL | \$56,795,768,600 |

* Number of homes sold is an estimate based on total deeds recorded x 75%.
(Method suggested by Shirley Stephenson of Security Pacific National Bank, Economics Dept.)

However, the total additional costs assume that the new buyer would fully pay off these additional costs. In reality, only a portion of them are paid off, until the new buyer sells to a succeeding buyer. In the interim, financing costs are incurred (summarized in Table XV). Because these homes are typically financed at prevailing interest rates, we can further project the additional principal and interest costs associated with financing the differential costs, assuming an average mortgage length of 7 years (U.S. average) for each new home mortgage.

TABLE XV

| YEAR | AVERAGE PRICE DIFFERENTIAL ¹ | MONTHLY AMORTIZATION AT THEN-CURRENT INT. RATE ² | LENGTH OF AVG. MORTGAGE | NO. OF HOMES SOLD IN YEAR ³ | TOTAL ADDITIONAL COSTS TO SO. CALIF. HOMEBUYERS, DUE TO HIGHER MEDIAN PRICES |
|------|---|--|-------------------------------|---|---|
| 1975 | \$ 1,700 | = 14.30 | X 84 mos./or 7yrs. | 324,650 | \$ 389,969,580 |
| 1976 | 6,500 | = 53.49 | X 84 mos. | 401,953 | 1,806,039,141 |
| 1977 | 15,300 | = 125.88 | X 84 mos. | 460,123 | 4,865,039,141 |
| 1978 | 27,100 | = 237.83 | X 84 mos. | 446,610 | 8,922,249,529 |
| 1979 | 35,800 | = 354.54 | X 84 mos. | 456,544 | 13,596,382,090 |
| 1980 | 47,700 | = 527.67 | X 84 mos. | 381,853 | 16,925,226,320 |
| | | | | | \$46,505,170,452 |

¹ Federal Home Loan Bank Board

² Interest Amortization Tables", Jack Estes, McGraw-Hill Paperbacks, 1976. Of this total (\$46 billion), \$45.93 billion went for interest payments and the rest went to principal payments by 1980.

³ Number of homes sold is an estimate based on total deeds recorded x 75%. Methodology suggested by Shirley Stephenson of Security Pacific Bank, Economics Dept.

In summary, Table XIV shows that inflation has taken over \$46 billion in purchasing power from one segment of the population (purchasers) and redistributed that amount among the sellers and financial institutions. Please note this analysis only covers owners of single-family housing. The impact of inflation on rental properties was not analyzed.

In addition to these costs, several "add-on" costs to the homeowner increase proportionately as the value of the unit increases. These are typically:

- a) Transaction costs to sell property, including brokers' fees and closing costs
- b) Property taxes (before & after Prop. 13)
- c) Mortgage, hazard, fire, insurance, etc.
- d) Others

Analysis of Costs

There appears to have been a basic shift in wealth due to inflated housing prices. This shift has probably occurred (in simplistic terms) between pre-1975 owners and post-1975 owners, without respect to the current income of the seller, race, ethnicity, age, etc. This shift has several effects, including:

- a) Decreased purchasing power of buyers, and high percentages of current income devoted to mortgage payments. Less money is left for other purchases food, clothing, automobiles, etc. Therefore, the rest of the economy suffers.
- b) Increased purchasing power of sellers. Those "trading up" to a higher-price home may artificially stimulate the local economy and inflate new home prices. External benefits to government are realized through increased taxes and revenues.
- c) External benefits go to lending institutions, realtors, new home developers, insurance companies, state and federal tax collectors, etc.
- d) Investors and speculators reap rewards in such an inflated market, and "pyramiding" of properties is encouraged (take inflated value out of one property, use as equity in another, ad infinitum).

¹ Real Estate Research Council of Southern California, "Southern California & National Average Home Prices", 3rd Qtr., 1980, p. 30.

Direct Benefits

As the average price of a home increases, there are at least three effects. One of these is on recent purchasers, who typically have to pay the increased costs outlined above.

The second effect is on all current homeowners. The relative price of new housing affects the price of existing units (and is a function of it). Thus, current homeowners reap a "paper" profit (actual profit, if they sell) on their property equal to the inflationary gain over the U.S. averages. The important difference between the existing-owner inflation (shown under "benefits" here) and the cost section above, is that current homeowners do not "pay" current prices, but prices negotiated in the past, when they bought the unit. They have been the primary gainers from the inflationary price spiral. These benefits are hard to calculate, since they depend on when the house was purchased, and an unknown future selling date. Also, each move in the same market means that their previous profits are only plowed into another house whose price may be inflated by an amount equal to profit taken. For example, if everyone in the current market bought in 1974 and sold in 1980, then "additional" inflationary benefits would be as follows:

Total Housing Stock: 4,000,000 units

Excess Appreciation Over U. S. Average: \$47,700

$4,000,000 \times \$47,700 = \$190,800,000,000$ (\$190 billion)

Subtract excess costs for sales, rehabilitation, closing costs, etc.

Economic Costs of Lost Production

Some beneficial economic tradeoffs might accrue to Southern California by reducing inflationary cost effects. For example, if we posit for California an equilibrium housing price equal to the U.S. average, or a balance of demand and supply, or a normal vacancy rate, then we can estimate how many additional units could have been built that were not. Hence, we can estimate the productivity lost to the construction industry in Southern California.

To achieve the "normal" 5% vacancy rate in Southern California (the present rate is 1.8%), 140,000 housing units -- an amount equal 3-1/2% of the present stock -- would have to be added. If we set the equilibrium house price for Southern California equal to the U.S. median price (\$71,000), then the following equation shows the additional economic investment in housing lost by the present shortage, assuming that additional households could afford units at this new price:

$140,000 \times \$71,500 = \$10,010,000,000$ (\$10 Billion)

Besides productivity lost directly in the construction sector, the "multiplier effects" of construction employment are also lost. The Building Industry Association estimates that 3.34 jobs are generated for each job increase in construction.¹

Business activity is also affected; an estimated \$4.19 in new business activity is generated for each dollar spent in construction. As the multiplier effects of lost housing production are considered, lost productivity grows exponentially.²

¹ Industry Research Board, memo by Ben Bartolloto, 1980.

² Ibid.

VIII. TRENDLINE ANALYSIS: A SCENARIO FOR THE FUTURE?

If regional housing costs go on rising at current rates, the average home in 1985 would cost \$249,000, and by 1990 would exceed \$500,000. This estimate is based upon a compound rate of the average increase in house prices which occurred between 1970 and 1980, about 15%. If home prices should be about three times annual household income, the income needed to buy the average home in 1990 would be more than \$160,000 a year.

By contrast, median income in Los Angeles County rose by just over 7% (compounded) between 1974 and 1980. Projecting this rate forward to 1990, the median income would be \$41,900. Assuming that the 1980 interest rate of 13.25% continues, mortgage payments on the "average" \$500,000 home, with an 80% loan, exceed the projected median income. This implies a lack of effective housing demand for all but the very rich.

While the gap between housing prices and incomes continues to widen, it is doubtful that prices can continue to rise for long at their present rate. Data indicate that monthly appreciation rates fell slightly in the last few months of 1980. While it is hard to predict market fluctuations for the future, the strongest long-term trends make a convincing case for sustained increases in home values and the widening of the housing/income gap.

Political Implications

Lack of mobility, housing cost burdens, displacement, and other effects of the housing shortage now involve increasingly large segments of the population. The economic viewpoint, that rising housing costs simply stem from the interaction between supply and demand, is lost in the personal perspective, where prices limit access to community amenities, jobs, social contacts, security, and other fundamental needs. The housing problems of Southern California are gaining expression in the political arena.

This effect is already seen at the local level, as citizens try to preserve or enhance their housing options through legislation. Renters have organized to seek price relief, and rent controls have been adopted in several areas of the SCAG region. Ordinances limiting condominium conversion, demolitions, and other actions reducing the supply of rental housing have also been adopted. To some extent, such policies may slow the physical upgrading of neighborhoods. However, they may also slow the social upheaval arising from a lack of affordable housing.

Homeowners also have brought their concerns to local decision-makers. Residents of low-density, single-family neighborhoods may oppose new developments or new regulations permitting higher-density housing. Whether their concerns are environmental or, as Frieden argues, predominately economic,¹ their desire to preserve and enhance the investment value and ambience of their homes increases as home prices rise. The conflict between "haves" and "have nots" becomes accentuated.

Potential homeowners and renters are at a disadvantage in the local political process because they may not have a voice in land-use decisions. If they cannot "vote with their feet" at the local level, they may seek redress at higher political levels. Increasing state, federal, and judicial intervention into local land-use decisions may arise from this conflict.

The loss of economic incentives to increase the housing supply presents another complex array of issues and problems. The lack of adequate means of financing infrastructure and other services for new housing -- means acceptable to current residents and affordable to potential residents -- are difficult questions for local decision-makers. Should housing costs negatively impact upon economic development, local revenue-raising capacity could be further impaired.

While a lack of sufficient housing may negatively impact the total growth of the local economic base, the pressure to convert other land uses to housing could have a similar effect. There is an appropriate balance -- integral to strong local economies -- among industrial, commercial, retail and residential supply and demand. However, achieving or maintaining this balance may require local governments to take a lead in developing public/private programs to assure an adequate supply of housing for persons underserved by today's market.

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**Costs, Causes and Consequences
of the Housing Shortage**

